

DIRECT TESTIMONY OF**ROBERT B. HEVERT****ON BEHALF OF****SOUTH CAROLINA ELECTRIC & GAS COMPANY****DOCKET NOS. 2017-207-E AND 2017-305-E**

1 **Q. PLEASE STATE YOUR NAME, AFFILIATION, AND BUSINESS**
2 **ADDRESS.**

3 A. My name is Robert B. Hevert. I am Partner of ScottMadden, Inc.
4 (“ScottMadden”). My business address is 1900 West Park Drive, Suite 250,
5 Westborough, Massachusetts, 01581.

6 **Q. ON WHOSE BEHALF ARE YOU SUBMITTING THIS TESTIMONY?**

7 A. I am submitting this testimony (“Direct Testimony”) to the Public Service
8 Commission of South Carolina (“Commission”) on behalf of South Carolina
9 Electric & Gas Company, referred to throughout my Direct Testimony as
10 “SCE&G,” or the “Company.”

11 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

12 A. I hold a Bachelor’s degree in Business and Economics from the University
13 of Delaware, and an MBA with a concentration in Finance from the University of
14 Massachusetts. I also hold the Chartered Financial Analyst designation.

1 **Q. PLEASE DESCRIBE YOUR EXPERIENCE IN THE ENERGY AND**
2 **UTILITY INDUSTRIES.**

3 A. I have worked in regulated industries for more than 30 years, having served
4 as an executive and manager with consulting firms, a financial officer of a publicly
5 traded natural gas utility, and an analyst at a telecommunications utility. In my
6 role as a consultant, I have advised numerous energy and utility clients on a wide
7 range of financial and economic issues, including corporate and asset-based
8 transactions, asset and enterprise valuation, transaction due diligence, and strategic
9 matters. As an expert witness, I have provided testimony regarding various
10 financial and regulatory matters in more than 250 proceedings before numerous
11 utility regulatory agencies, including the Federal Energy Regulatory Commission
12 and the Alberta Utilities Commission. A summary of my professional and
13 educational background, including a list of my testimony in prior proceedings, is
14 included as Attachment A to my Direct Testimony.

15 **Q. ARE YOU THE SAME ROBERT B. HEVERT WHO PREVIOUSLY FILED**
16 **TESTIMONY IN DOCKET NO. 2017-370-E?**

17 A. Yes. On August 2, 2018, South Carolina Electric & Gas Company
18 (“SCE&G” or the “Company”) and Dominion Energy, Inc. (“Dominion Energy”)
19 (together, the “Joint Applicants”) filed on my behalf 78 pages of direct testimony
20 and six exhibits in Docket No. 2017-370-E. Therein, I provided information to the
21 Commission regarding an estimate of the Company’s current market-required
22 Return on Equity (“ROE” or “Cost of Equity”), which my analyses indicate

1 currently is in the range of 10.25 percent to 11.00 percent. Based on the
2 quantitative and qualitative analyses discussed throughout my direct testimony in
3 that proceeding, I concluded that an ROE of 10.75 percent is most reasonable and
4 appropriate for the Company.

5 I then compared that market-required return with the *pro forma* ROE under
6 four scenarios: (1) the “Customer Benefits Plan;” (2) the “No Merger Benefits
7 Plan;” (3) the “Base Request;” and (4) the “Experimental Rates” that would result
8 under Act 258 enacted by the South Carolina General Assembly on June 28, 2018
9 (the “Act”) if such rates are made permanent. I concluded that the *pro forma*
10 effect of the Experimental Rate, if made permanent, would reduce the Company’s
11 ROE to a level far below the lowest return authorized for any vertically integrated
12 electric utility since at least 1980. Such a return clearly would fail to meet the
13 Comparable Risk, Capital Attraction, and Financial Integrity standards established
14 by *Federal Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944)
15 (“*Hope*”) and *Bluefield Water Works and Improvement Co. v. Public Service*
16 *Comm’n.* 262 U.S. 679, 692 (1923) (“*Bluefield*”). By my plain reading of those
17 standards, the *pro forma* return that would result under the Experimental Rate, if
18 made permanent, would be neither just nor reasonable and, in my opinion, would
19 be confiscatory in the context of the standards.

1 **Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN DOCKET**
2 **NOS. 2017-207-E AND 2017-305-E?**

3 A. The purpose of my Direct Testimony in these proceedings is to provide
4 information and my expert opinion regarding the financial consequences that may
5 result if the Commission were to grant the requests filed by the Friends of the
6 Earth and the Sierra Club (collectively, “FOE”) in Docket No. 2017-207-E (“FOE
7 Request”) or the request filed by the South Carolina Office of Regulatory Staff
8 (“ORS”) in Docket No. 2017-305-E (“ORS Request”). In addition, I will provide
9 information and my expert opinion regarding the effect on SCE&G and SCANA if
10 the FOE Request or the ORS Request is granted, or if the temporary reduction in
11 SCE&G’s rates, which was imposed pursuant to Act 258 and by way of Order
12 Nos. 2018-459 and 2018-460, are made permanent. I also adopt and incorporate
13 my direct testimony and exhibits filed in Docket No. 2017-370-E, and update and
14 supplement that testimony to discuss events that have occurred since it was filed.

15 **Q. DOES YOUR DIRECT TESTIMONY FILED IN DOCKET NO. 2017-370-E**
16 **DISCUSS ISSUES THAT RELATE TO YOUR OPINIONS IN THESE**
17 **MATTERS?**

18 A. Yes. Among other things, my direct testimony in Docket No. 2017-370-E
19 addresses the effect the Experimental Rates will have on SCE&G. Specifically, I
20 explained that if the rate reduction provisions of the Act were made permanent,
21 resulting in a reduction to SCE&G’s annual retail electric revenue of \$367 million,
22 SCE&G’s earned ROE would be 5.16 percent. I noted if the rates contemplated

1 by the Act were permanent rates, for financial accounting purposes SCE&G would
2 be required to record a total impairment of approximately \$2.90 billion, which
3 includes the cumulative capital cost impairment of \$2.4 billion. After that
4 impairment, the ROE would increase to 6.67 percent, but there would be no
5 additional earnings to provide a return to investors; the increased ROE is caused
6 entirely by the impairment, recognized for accounting or regulatory purposes.

7 I also testified that, under the Experimental Rate and certain other
8 scenarios, the market-required Cost of Equity is likely to increase. Although I did
9 not attempt to precisely quantify how investors would react to a decision that
10 makes the Experimental Rates permanent and effectively authorizes an ROE of
11 6.67 percent, based on a significantly impaired equity base, my experience, and
12 research, I do know that such a low return has never been authorized in the United
13 States for an electric utility comparable to SCE&G. What is clear and
14 indisputable, however, is that when the Company's financial integrity is
15 compromised—as it would be under various scenarios discussed above—its
16 market-required Cost of Equity would be substantially greater than my 10.75
17 percent estimated ROE and that a much higher required return would be paid by
18 customers for years to induce investors to recapitalize the firm. Based on my
19 analysis, I stated my view that the incremental returns required by equity investors
20 in SCE&G, assuming the Experimental Rates were made permanent, would be in
21 the range of 220 to 625 basis points or in the range of 12.95 percent to 17.00

1 percent, and I believe the Company's Cost of Equity under the Experimental
2 Rates, if made permanent, would be at the higher end of the range.

3 Because these same issues pertain to the FOE Request and the ORS
4 Request, I adopt and incorporate herein my direct testimony and exhibits filed in
5 Docket No. 2017-370-E and have attached a copy thereof to this testimony as
6 Appendix A. The remainder of my direct testimony in this proceeding
7 supplements and updates this prior testimony.

8 **Q. HAVE YOU REVIEWED THE TESTIMONY FILED BY FOE AND ORS IN**
9 **DOCKET NOS. 2017-207-E, 2017-305-E, AND 2017-370-E?**

10 A. Yes.

11 **Q. DOES EITHER FOE'S OR ORS'S TESTIMONY CAUSE YOU TO**
12 **RECONSIDER OR REVISE THE TESTIMONY YOU FILED IN DOCKET**
13 **NO. 2017-370-E?**

14 A. No. My previously filed testimony remains true and correct.

15 **Q. HAVE ANY SIGNIFICANT EVENTS OCCURRED SINCE THE TIME**
16 **YOUR DIRECT TESTIMONY WAS FILED IN DOCKET NO. 2017-370-E?**

17 A. Yes. on August 6, 2018, the United States District Court for the District of
18 South Carolina (the "District Court") denied a Motion for Preliminary Injunction
19 filed by SCE&G and seeking to stay the effect of Act 258 and to enjoin the
20 Commission from instituting or implementing any of Act 258's provisions,
21 including its mandated retail electric rate reduction and refund provisions.
22 Following this decision, on August 8, 2018, Fitch Ratings ("Fitch") downgraded

1 the long-term credit ratings of SCE&G from BBB- to BB+ and of SCANA from
2 BB+ to BB. The next day (August 9, 2018), Standard & Poor's Corporation
3 ("S&P") followed suit downgrading SCANA and SCE&G from BBB to BBB-.
4 The reports issued by Fitch and S&P regarding the downgrades are attached to my
5 Direct Testimony as Exhibits ____ (RBH-1) and ____ (RBH-2), respectively.

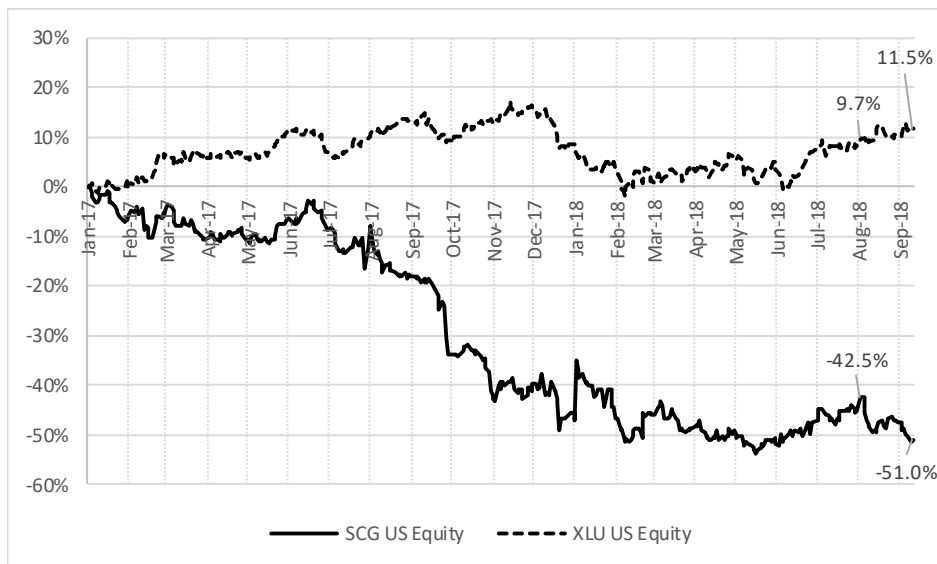
6 **Q. WHAT FINANCIAL EFFECT HAS THIS DECISION HAD ON THE**
7 **COMPANY?**

8 A. As discussed in my direct testimony in Docket No. 2017-370-E, one means
9 of estimating the incremental return required by equity investors if the Company
10 had fallen below investment grade was to consider the difference in yields on BBB
11 and BB-rated utility bonds. My testimony explained that difference—about 220
12 basis points—likely is a conservative measure of the incremental return required
13 by equity investors given the additional risks they face relative to debt investors.
14 Because the Company now has fallen below investment grade by Fitch, there is
15 little question its Cost of Equity has increased, and the 220-basis point estimate is
16 an objective, but conservative measure of that increase.

17 There also is little question the equity market has reacted to the rate
18 reduction. As Chart 1 (below) demonstrates, from January 2017 to August 3, 2018
19 SCANA lost about 42.50 percent of its value whereas the utility sector (as
20 measured by the XLU, an exchange-traded fund of utility companies) gained 9.70
21 percent. By September 12, 2018 the XLU gained an additional 1.80 percentage
22 points, while SCANA lost 8.50 percentage points. That is, in the course of about

one month, SCANA underperformed the sector by more than 10.00 percentage points such that it now has underperformed the utility sector by 54.00 percent.

Chart 1: Relative Performance Since January 2017¹



Taken together, the downgrade to below investment grade by Fitch and the more than 10.00 percentage point under-performance following the District Court's decision not to enjoin the reduced rates, support the position that the Company's Cost of Equity has risen well above the returns required of other electric utilities. I note that neither FOE nor ORS offered testimony in Docket Nos. 2017-207-E or 2017-305-E regarding whether the FOE Request or the ORS Request, if implemented, would result in rates that are fair and reasonable. In light of the recent events I have described, and based on my plain reading of the *Hope* and *Bluefield* standards, it is clear that the rates proposed by either FOE or ORS in this proceeding would not be fair or reasonable. Further, for the reasons discussed

¹ Source: Bloomberg Professional.

1 earlier, the *pro forma* return that would result under these rates, in my opinion,
2 would be confiscatory on its face.

3 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

4 A. Yes, it does.